Aankhu Khola Jalvidhyut Company Limited

ICRA Nepal assigns [ICRANP] IPO Grade 5 to the proposed Initial Public Offering (IPO) of Aankhu Khola Jalvidhyut Company Limited

Instrument/Facility	Issue Size	Grading Action (July 2018)
IPO (equity) Grading	NPR 200 million	[ICRANP] IPO Grade 5 (Assigned)

ICRA Nepal has assigned an "**[ICRANP] IPO Grade 5**", indicating poor fundamentals to the proposed Initial Public Offering (IPO) of Aankhu Khola Jalvidhyut Company Limited (AKJCL). ICRA Nepal assigns IPO grading on a scale of IPO Grade 1 through IPO Grade 5, with Grade 1 indicating strong fundamentals and Grade 5 indicating poor fundamentals. For the grading categories 2, 3 and 4, the sign of + (plus) appended to the grading symbols indicate their relative better position within the grading categories concerned. AKJCL is proposing to come out with an Initial Public Offer of 2,000,000 numbers of equity shares of face value NPR 100 each at par. Of the total shares, 800,000 shares will be issued to project affected areas while remaining 1,200,000 shares will be issued to general public and staff.

The assigned grading is constrained by the poor financial profile of AKJCL involved in development and operations of 8,400 KW hydro-electric project (HEP). High project costs (~NPR 281 million per MW) coupled with fixed tariff have impacted the profitability of the company. The grading is also constrained by moderate operational performance of the HEP with plant load factor (PLF) at net generation of ~53% in FY2017 and ~47% in 11MFY2018 as against the contract energy PLF of ~63% and ~60% respectively, which coupled with high financial leverage, has resulted in weak earnings and insufficient cash flows. This has, apart from impacting project returns, also resulted in requirement of additional funds (in the form of loans from promoters) to meet funding gap. Lack of strong institutional promoters and diversified promoter base[1] limits the quantum of support that can be expected from promoters in future. Grading concerns also emanate from risks arising from any loss of generation due to insufficient hydrology which could further impact the project earnings and returns. The project is also exposed to substantial risks arising from interest rate volatility in the market as the loan repayment period has been extended over 20 years and also to counterparty credit risks arising out of exposure to loss-making Nepal Electricity Authority (NEA) for the energy supplied, although the same is partly mitigated by the fact that NEA is fully owned by the Government and has been making timely payments to AKJCL so far.

Aankhu Khola HEP is the first hydropower project developed by AKJCL. Delayed by ~18 months compared to Required Commercial Operations Date (RCOD) of February 2012, the project has been in operation since August 2013. The project was commissioned at a cost of NPR 2,364 million funded in a debt: equity mix of ~72:28. The tariff rates for contract energy as per PPA (Power Purchase Agreement) with NEA are NPR 4 and NPR 7 for wet and dry seasons respectively; subject to annual escalation after Commercial Operation Date (COD) @ 3% on base tariff for 9 years. Under the Government's initiative of promoting private sector hydropower developers, the project is eligible for promotional tariff rates of NPR 4.80 and NPR 8.40 per unit in wet and dry seasons; which shall remain effective for up to 7th year after proposed COD with 5 times annual escalation of 3% on base tariff. The electricity sales revenue shall thereafter be based on the rates as per PPA. The power generated by the project is evacuated via 12 km, 33kVA transmission line to Dhadingbesi sub-substation.

Since the revenues are entirely linked to unit sales from a single operational project, the project returns, and the financial health of the company are entirely dependent on the hydrology of the project stream. The project has operated at PLF (at net generation) of 50-55% during FY2015-FY2017 vs. annual design energy PLF of ~63% and thus generated an average of ~80-85% of contract energy resulting in sizeable revenue loss, in addition to occasional short supply penalty. Owing to slight improvement in generation in FY2017, net energy supplied was ~85% of contract energy (~80% in FY2016) and hence AKJCL posted gross sales revenue of ~NPR 218 million in FY2017 compared to ~NPR 205 million in FY2016. However, despite the growth in revenue, the company reported higher losses of ~NPR 24 million over OPBDITA of ~NPR 183 million during FY2017 vs. losses of ~NPR 6 million during FY2016 over OPBDITA of ~NPR

[1] >1,100 promoters hold 100% of capital as of now.

171 million. This was mainly due to lower non-operating income; AKJCL has reversed contractor and other liabilities during last two years (~NPR 66 million and ~NPR 31 million respectively) that prevented the company from reporting higher losses. As such reversals has remained nominal in 9MFY18 and also generation being slightly lower (net PLF of ~51% vs. contract PLF of ~61% for the period i.e. ~16% short of contract energy), the company reported loss of ~NPR 26 million over OPBDITA of NPR 148 million.

As the company has sustained sizeable losses so far, its net worth per share has depleted to ~NPR 54 (vs. face value of NPR 100 each) as of Apr-18. Significant interest expenses have been impacting the profitability, accordingly the management plans to utilize the current IPO proceeds towards downsizing bank loans (with plans to settle other project liabilities later on) could provide some comfort. The company had ~NPR 1,535 million of outstanding term loan payable to the consortium banks as on mid-April 2018 as per provisional financials, translating into a gearing ratio of 4.79 times. AKJCL's track record of debt servicing (which began from mid-April 2015 and is spread over 20 years) remains supported by ballooning repayments which entail small portion of principal repayment in initial years. However, volatile interest rate scenario seen in banking sector remains a concern to this end. Going forward, the ability of the project to achieve its design operating parameters will be the most important driver for the project returns.

Company Profile

Incorporated in 2008 as a private limited company, AKJCL was subsequently converted into public limited company in August 2010 to facilitate public participation. Promoters account for the entire paid up capital of the company as of now and the promoter holding is expected to dilute to 75% after proposed IPO, assuming full subscription. The shares of the company are proposed to be listed in the stock exchange post proposed IPO. As a part of the IPO process, the company would issue 10% of its post IPO paid-up capital to the local inhabitants of project affected areas following which remaining 15% capital shall be offered to general public and staffs of the company. The company is at present operating 8,400 KW Aankhu Khola -1 hydro-electric project, located in Salyankot and Marpak VDCs of Dhading District in Central Nepal.

July 2018

For further details please contact:

Analyst Contacts:
Mr. Kishor Prasad Bimali, (Tel No. +977-1-4419910/20)
kishor@icranepal.com

Mr. Rajib Maharjan, (Tel No. +977-1-4419910/20)
rajib@icranepal.com